

February 11, 2004

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station
Boston, MA 02110

Boston Edison Company, Cambridge Electric Light Company, Commonwealth Electric and NSTAR Gas Company, D.T.E. 04-2

Dear Secretary Cottrell:

The Department of Telecommunications and Energy (the “DTE” or “Department”) approved the BEC Energy / Commonwealth Energy merger in D.T.E. 99-19. *BEC / ComEnergy Acquisition*, D.T.E. 99-19 (1999) (the “Order”). As part of its merger approval, the Department ordered a four year rate freeze and directed the newly associated distribution companies (“NSTAR”) to file a report of “cost savings measures taken and results achieved during the rate freeze” ninety days after the termination of the rate freeze. On December 5, 2003, the Company filed with the Department the Merger Savings Report (the “Report”). On January 27, 2003, the Department issued a Notice allowing comments from interested parties. The Department should open a full investigation into the Report to determine the accuracy of the reported savings.

The Department required NSTAR to produce a detailed and “well-documented report” to the Commissioners:

[T]hat joint report of all four companies will be due not later than 90 days after the end of the rate freeze (or not later than the filing by any of the four companies of a future rate proceeding, should such a proceeding occur first). The first report should draw upon contemporaneous documentation developed and maintained through the period of the rate freeze. A thorough and well-documented report can offer sufficient assurance that the savings achieved during the rate freeze can and will persist well beyond the initial period. The savings initiatives described by the Joint Petitioners are of a kind that, once instituted, will serve as a baseline for future rate proceedings.

Order., p. 86. NSTAR’s Report filed with the Department contains errors and inflated measures of the cost savings as a result of the merger. The following is an initial list of issues that arise

from the Report. It is not intended to be an all-inclusive list, since responses to discovery will likely lead to many follow-up questions and possibly new areas of concern.

- The Company bases its savings analysis in the Report on the Company's original estimates of costs filed in D.T.E. 99-19, rather than on an updated analysis of the costs the companies actually would have experienced without the merger. The most important of these areas is the overstatement of the escalation of stand-alone costs. The Company originally forecast the escalation to be 2.5 percent annually for the period, while inflation was actually less than 1.8 percent, using the Gross Domestic Product Chain-Type Price Index. Furthermore, the 1.8 percent inflation rate would not provide for any productivity gains (the X-Factor) that should be on the order of one and one-half percent per annum. Therefore, the more appropriate annual rate of escalation in costs that the Department should use to compare to actual costs is 0.3 percent, rather than the 2.5 percent that the Company proposes.
- The Company inappropriately included in its merger savings the return to customers of sales proceeds that were a result of divestiture of generation assets required by the Electric Restructuring Act of 1997, not the NSTAR merger. This figure included the return of proceeds from the sale of the Blackstone Generating Station assets from D.T.E 02-76.
- The Company in several instances claims savings as the result of reductions in the number of employees associated with "re-engineering" particular activities, without netting out the costs of the "re-engineering" itself. This figure included the costs of the lock-box services that substituted for the treasury function employees, and the outsourcing of legal functions to substitute for legal department employees.
- The Company included the savings associated with the elimination of possible computer software upgrades even though those upgrades were not shown to be required or necessary.
- The Company included the reduction in employee benefits as a merger related savings. While reducing employee benefits does save the Company money, it is not, and should not be considered a synergy, an economy or greater efficiency related to merging the two companies together.
- The Company appears to be using the change in inventory levels resulting from the merger as a cost savings. Of course, it is only the carrying charges on the change in the balances of inventory levels that create any savings.
- The Company claims significant savings associated with the procurement of its standard offer and default service on a combined basis. This figure is at best speculation, since there has been no showing that there are any savings associated with a combined firm acquiring these services on its own, as opposed to each acquiring separately.

- The Company uses the reduction in costs from its move from the Prudential building to the Westwood facility as a merger savings. The move from the Prudential, although coincident with the merger, was not related to the merger and should not be included in the merger savings analysis. The Company planned to move out of the Prudential prior to the merger.
- The Company improperly included in its analysis the cost reduction associated with the decrease in the number of gas company distribution service employees. Since the gas distribution service function cannot be merged with any other function from the electric companies, the reduction compromises service quality and should not be included in the merger savings determination.
- The Company includes in its merger savings analysis reductions in the level of electric distribution service field employees. This reduction in employee levels in 2001, however, was apparently too great for safe and reliable service, because the Company increased their numbers significantly in 2002. While the Company should be credited for some reduction in this employee function that led to greater efficiencies, it should not get any credit when reductions led to a loss of service quality.

As a result of these many problems with the Report, the Department should perform a full investigation into the savings calculations and claims of cost increases. *See* Filing Cover Letter to Mary Cottrell, p. 2, note 1. The Attorney General requests discovery, sworn testimony, hearings and briefing before the Department approves the Report for any purposes.

Sincerely,

Alexander J. Cochis
Assistant Attorney General
Utilities Division